Supreme Court, U.S.
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No. 04-722

IN THE

# Supreme Court of the United States

MARTIN BROS. CONTAINER & TIMBER PRODUCTS CORP., an Ohio Corporation; MARTIN BROS. CONTAINER & TIMBER PRODUCTS CORP., a Tennessee Corporation,

*Petitioners*,

*v.*

RAYMOND J. MARTIN; DOLORES J. MARTIN; CECELIA A. AUSTIN,

*Respondents.*

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

## BRIEF IN OPPOSITION

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## STATEMENT OF CASE

Respondents substantially agree with Petitioners' statements regarding the case and the factual proceedings as set forth in their Petition. However, Respondents disagree with Petitioners' assertion on Page 5 of the factual and procedural history in the present case. Petitioners quote *Curry v. United States*, that "It is well established as the willing-buyer-willing seller rule presumes that the potential transaction is to be analyzed from the viewpoint of a hypothetical buyer whose only goal is to maximize his advantage." *Curry v. United States*, 706 F.2d 1424, 1428 (7th Cir. 1983). This states only a portion of the standard to be applied.

Respondents submit that a more comprehensive statement of the standard to be applied when determining fair market value is more completely set forth in the following:

> In summary, the primary judicially developed standard as to fair market value is:
>
> (1) The buyer and the seller are a willing-buyer and a willing-seller;
>
> (2) Neither the willing-buyer nor the willing-seller is under a compulsion to buy or to sell the item in question.
>
> (3) The willing-buyer and the willing-seller are both hypothetical persons;
>
> (4) The hypothetical willing-buyer and hypothetical willing-seller are both reasonably aware of all relevant facts involving the items in question;

(5) The item in question is valued at its highest and best use; and

(6) The item in question is valued without regard to events occurring after the valuation date to the extent that those subsequent events are not reasonably foreseeable on the date of evaluation. *Bank One Corp. v. Commissioner* 120 T.C. 174, at 260 and 261.

The hypothetical willing-buyer and hypothetical willing-seller are both presumed to be dedicated to achieving the maximum economic advantage. *Id.* at 260.

Petitioners argue that analysis is made strictly from the viewpoint of the buyer, which is not the case.

## SUMMARY OF ARGUMENT

Granting Petitioner's Petition for Writ of Certiorari is not appropriate in this case. The basis for the Petition, that there is a conflict between circuits regarding the degree to which potential capital gains taxes are to be considered in a willing buyer-willing buyer valuation context, is an issue that Petitioners made no argument asserting such in Respondents' Appellate Briefs or in oral argument. The Sixth Circuit, in its Per Curiam Opinion, also made no mention of any purported conflict between its position and any other. Finally, as is demonstrated below, the purported conflict is resolved from an understanding of the differing contexts between the case at bar and that with which the conflict is alleged.

The sole issue raised by Petitioners is whether a willing buyer will, as a matter of law, require a dollar-for-dollar reduction from the purchase price he is willing to pay for stock of a willing seller for all of the taxes potentially owed upon the built-in capital gains embedded in a C corporation. Petitioners are attempting to take a matter that is state law specific, Ohio Revised Code Section 1701.85, and boot strap their way into this Court by attempting to claim that the matter has great importance in gift and estate tax when, in fact, the matter before the Circuit Court has nothing to do with estate and gift taxes. Petitioners ignore the fact that no Ohio or Federal District Court that has ever been called upon to review the statute in question. It therefore, is not likely to be an important matter in any future proceeding under the statute in question.

## I. Review Of Issues Neither Raised Nor Passed Upon Below Is Strongly Disfavored.

It has been well established by this Court that "where issues are neither raised before nor considered by the Court of Appeals, this Court will not ordinarily consider them." *Adickes v. S. H. Kress & Co.*, 398 U.S. 144, 148 n.2 (1970). Further, only in "exceptional cases" is consideration of issues never raised or passed upon below appropriate. *Youakin v. Miller*, 425 U.S. 231, 234 (1976).

In none of Petitioners' arguments, either before the District Court or the Sixth Circuit Court of Appeals, has the issue been raised of a conflict among the circuits over whether the full amount of the potential taxes owed upon built-in capital gains will, as a matter of law, be deducted in an asset approach valuation of a C corporation by a willing buyer of the stock of the corporation. Throughout all proceedings

on this matter, Petitioners have argued that *Dunn* v. *Commissioner of Internal Revenue*, 301 F.3d 339 (5th Cir. 2002) is the logical outgrowth of the Second and Sixth Circuit Courts' decisions in *Eisenberg v. Commissioner of Internal Revenue*, 155 F.3d 50 (2d Cir. 1998) and *Welch v. Commissioner of Internal Revenue* 208 F.3d 213 (6th Cir. 2000) (unpublished). Petitioners argued below that *Eisenberg* and *Welch* were applied by *Dunn* to develop the two-prong test to the "BIG" deduction.[1] This is interesting, since *Eisenberg* and *Welch* were never discussed, cited or mentioned in *Dunn*. Petitioners have previously never argued that *Dunn* was in conflict with *Eisenberg* and *Welch*.

## II. Review Is Unwarranted Because The Alleged Conflict Among The Circuits On This Issue Is Neither Sufficient In Importance Or Profound.

While the issue of what constitutes the appropriate consideration of taxes upon imbedded capital gain in valuation context may have importance in estate tax and gift tax valuation, it has never previously been raised in the context of the Ohio Statute in which this action arises. (*1701.85 Ohio Revised Code*) The Ohio statute upon which this action is based is set forth with the rights of minority shareholders on certain rare occasions to claim the fair cash value of their stock interest in a corporation.[2] The statute grants dissenting shareholders the right

1. "In essence, *Dunn* applied both the *Eisenberg* case and the *Welch* case in developing a two part test for application of the BIG deduction." *Defendants' Post Trial Brief*, at 6-7. "In essence, *Dunn* applied both the Eisenberg and the Welch case in developing a two part test for application of the BIG tax deduction." *Final Brief of Appellants*, United States Court of Appeals for the Sixth Circuit at 13.

2. 1701.85 (A)(1) A shareholder of a domestic corporation is entitled to relief as a dissenting shareholder in respect of the proposals described in Sections 1701.74, 1701.76 and 1701.84 of the Revised Code, only in compliance with this section.

to the fair cash value for their shares upon merger, sale of assets or change in certain shareholders' rights. This statute provides that the Court shall determine the "fair cash value" of the dissenting shareholder's shares, if the statute applies. (*O.R.C. 1701.85 (B)*). In determining "fair cash value", the Court applies the willing buyer, willing seller standard.[3]

This statute became effective July 1, 1994 and replaced previously-analogous statutes.[4]

During its entire history, both in its present form and in its previous forms, the issue of the potential tax upon built-in capital gains has never been an issue in any reported or unreported cases save the present matter. The statute in question has not been the subject of extensive litigation and is unlikely to be the subject of extensive litigation on this issue in the future, especially since most closely-held

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3. Under O.R.C. 1701.85 (C),

> the fair cash value of a share for the purposes of this section is the amount that a willing seller who is under no compulsion to sell would be willing to accept and that a willing buyer who is under no compulsion to purchase would be willing to pay, but in no event shall the fair cash value of a share exceed the amount specified in the demand of the particular shareholder.

4. 1701.85 is analogous to former 1701.85 repealed by 1970 S 158, eff. 7-17-70. Former 1701.85 repealed by 1970 S 158, eff. 7-17-70; 130 v S 121; 129 v 187, 582; 126 v 432. Former 1701.85 was analogous to prior 1701.80 repealed by 126 v 432, eff. 10-11-55; 1953 H 1; GC 8623-72. Prior 1701.85 repealed by 126 v 432, eff. 10-11-55; 1953 H 1; GC 8623-78; see now 1701.68 and 1702.37 for provisions analogous to prior 1701.85.

businesses are now formed as limited liability companies or Sub Chapter S Corporations. Simply because this matter has never been ruled on by the Ohio courts who have considered this statute, the parties looked to decisions of the various Federal District Courts and Tax Court for analagous decisions. These courts have previously ruled on the issue when valuing a C corporation stock for estate and gift tax purposes.

On its face, there appears to be a conflict on the treatment of built-in gains when valuing a C corporation under the asset method of valuation. However, the simple existence of a conflict among the Federal Circuit Courts of Appeal is not necessarily sufficient, standing alone, to warrant exercise of the Court's Certiorari jurisdiction. *See generally* Robert L. Stern, et al., *Supreme Court Practice* at 168-173 (7th ed. 1993). The Court's jurisdiction is properly reserved to resolve important issues of federal law, and then only when the split among circuits on an important issue is *profound* or *widespread* (emphasis added). *Id.* at 170-71. This matter fails to meet that test.

Respondents agree that the leading case supporting Respondents' position is the Second Circuit decision in *Eisenberg* and *Davis v. Commissioner*, 110 T.C. 530 (1998) and followed in the Sixth Circuit in *Estate of Pauline Welch.* Respondents disagree with Petitioners' assertion that *Eisenberg* concluded that only a portion of the potential to tax upon built-in capital gains should be recognized. The *Eisenberg* Court's conclusion is that "adjustment for potential capital gains tax liabilities should be taken into account in valuing the stock at issue in the closely held C corporation." *Eisenberg* at 59.

In *Eisenberg*, Mrs. Eisenberg gifted her shares in a closely-held C corporation to her son and grandchildren. *Eisenberg* at 52. This corporation's sole asset was real estate consisting of a commercial building. *Eisenberg* at 52. In her gift tax return, Mrs. Eisenberg's appraiser discounted the value of her gift by the full amount of the then-existing tax upon the built-in gain, as though the building had been sold and the gain was recognized. *Eisenberg* at 52. The IRS maintained its long-held position prior to repeal of *The General Utilities Doctrine* that no discount should be taken for potential taxes upon built-in capital gains and that gain, if any, was speculative, since no liquidation was planned and the willing buyer had the option to avoid the imposition of capital gain. *Eisenberg* at 56. The Tax Court upheld the position of the IRS, citing firmly-established precedent that there would be no reduction for potential taxes upon built-in gains, especially where evidence fails to establish that a liquidation or sale of the corporation or its assets is likely to occur, reasoning that the tax liability is purely speculative. *Eisenberg* at 54.

The Second Circuit rejected the conclusions of the Commissioners and the Tax Courts:

> Our concern in this case is not whether or when the donees will sell, distribute or liquidate the property at issue, but what a hypothetical buyer would take into account in computing fair market value of the stock. We believe it is common business practice and not mere speculation to conclude a hypothetical willing buyer, having reasonable knowledge of the relevant facts, would take some account of the tax consequences of

> contingent built-in capital gains on the sole asset of the Corporation at issue in making a sound valuation of the property.

155 F.3d at 57.

The *Eisenberg* Court further concluded that

> the issue is not what a hypothetical willing buyer plans to do with the property, but what considerations affect the fair market value of the property he considers buying. While prior to the TRA any buyer of a corporation's stock could avoid potential built-in capital gains tax, there is simply no evidence to dispute the fact that a hypothetical willing buyer today would likely pay less for the shares of a corporation because of the buyer's inability to eliminate the contingent tax liability.

155 F.3d at 57.

Further, the Court reached its conclusions based on the recent ruling at that time of *Davis*.

> We are convinced on the record in this case, and we find, that, even though no liquidation of (the corporation) or sale of its assets was planned or contemplated on the valuation date, a hypothetical willing seller and a hypothetical willing buyer would not have agreed on that date on a price for each of the blocks of stock in question that took no account of (the corporation's) built-in capital gains tax. We are also persuaded on that record,

> and we find, that such a willing seller and such a willing buyer of each of the two blocks of (the corporation's) stock at issue would have agreed on a price on the valuation date at which each such block would have changed hands that was less than the price that they would have agreed upon if there had been no built-in capital gains tax as of that date.

*Davis* at 550.

The conclusion of the *Eisenberg* Court is set forth in Footnote 16 of its decision.

> Where there is a relatively sizable number of potential buyers who can avoid or defer the tax, the fair market value of the shares might well approach the pre-tax market value of the real estate. Potential buyers who could avoid or defer the tax would compete to purchase the shares, albeit in a market that would include similar real estate that was not owned by a corporation. However, where the number of potential buyers who can avoid or defer the tax is small, the fair market value of the shares might be only slightly above the value of the real estate net of taxes. In any event, all of these circumstances should be determined as a question of valuation for tax purposes.

*Eisenberg* at 59.

In *Welch*, the Sixth Circuit built on *Eisenberg* and *Davis*. *Welch* involved an Estate Tax Return. The decedent, Pauline Welch, left to her heirs her minority stock interest in two closely-held C corporations. *Welch* at 1. One of the assets of one of the corporations was a piece of real estate that was targeted by the City of Nashville for eminent domain proceedings. *Welch* at 1. The estate evaluators used the net asset valuation method in calculating the value of Mrs. Welch's stock interest. *Welch* at 1. The evaluators for the estate failed to include any discount for potential taxes upon built-in gains on the real estate because the gain, as such, could be deferred indefinitely under the provisions of I.R.C. § 1033. However, when submitting its estate tax return, the estate discounted the stock for the full amount of the potential tax upon the built-in gains despite I.R.C. § 1033. *Welch* at 2. The Commissioner disagreed and issued a Notice of Deficiency, excluding the discount for the potential tax. *Welch* at 2. The Tax Court ruled favorably for the Commissioner. *Welch* at 2.

The Sixth Circuit overruled the Tax Court and remanded the matter back to the Tax Court, directing it to consider further evidence from experts. *Welch* at 7. The Court, citing *Eisenberg*, held that whether or not a discount should be allowed was a factual matter to be determined by competent expert testimony. *Welch* at 7. One of the reasons the estate evaluator did not include the potential tax upon the built-in gains was because I.R.C. § 1033 would have been available to defer all of the gain. In considering what affect the availability of I.R.C. § 1033 should have on the matter, the Court held as follows:

> The availability of a § 1033 election for nonrecognition treatment of the capital gain is a

> factor that a hypothetical buyer of the corporations' stock would consider, together with many other factors, in arriving at a fair market value of the stock, but it would not automatically foreclose a reduction in the value of the stock based on built-in capital gains tax liability as the Tax Court so held.

*Welch* at 5.

> N5. Incidentally, the Tax Court was in error by stating that, "A section 1033 election was available to the estate on the applicable valuation date." Only the taxpayers — the corporations — had that election, not the estate.

*Welch* at 5.

> Furthermore, even when a § 1033 election is available to a taxpayer, there are good reasons why a taxpayer would not want to elect nonrecognition, *e.g.* recognition now of the capital gain could be offset by loss carryovers that are about to expire. *See*, 2 Bittker & Lokken, *Federal Taxation of Income, Estates & Gifts, Second Edition*, § 44.1.3. [FN6] The point is that while a § 1033 election is available, the value of that election and its effect on the value of the stock depends upon all of the circumstances a hypothetical buyer of the stock would consider. The fact that, in the present case, the corporations *did* exercise the § 1033 election after the valuation date (Pauline Welch's death on March 18, 1993) is therefore irrelevant. In short, the question is what would a hypothetical buyer of the corporations' stock on March 18, 1993 pay for this

> stock knowing all of the corporations' circumstances, including the threatened condemnation of the real estate and the availability of a § 1033 election when the condemnation occurs. This is a factual issue to be determined from the evidence. The error of the Tax Court was holding, as a matter of law, that the availability of a § 1033 election prevented *any* discount in the value of the corporations' stock. For this reason, the judgment of the Tax Court should be reversed.

*Welch* at 5.

The Court further determines that:

> The proper approach in cases of this nature is not to deduct the built-in capital gains tax from the value of the appreciated real estate — as petitioners sought to do in the present case — because the question is not what is the value of the real estate, but what is the value of the stock with regard to all the circumstances, including the built-in potential capital gains liability if and when the real estate is sold.

*Welch* at 5.

It is clear that *Eisenberg*, *Davis* and *Welch* stand for the proposition that the Court must determine from expert testimony what a willing buyer would take into account when determining what, if any, discount should be given for built-in gains.

*Dunn* involved a different type of valuation method as well as the asset method. *Dunn* applied 100% of the potential tax liability upon built-in gains against the asset value.

Dunn Equipment was a Texas corporation owned by the Dunn family and employing 134 individuals. *Dunn* at 345. The business of the company was the ownership and rental of heavy equipment, primarily in the petroleum refining and petrochemical industry. *Dunn* at 345. Its assets consisted of the equipment, plus industrial real estate, accounting for approximately 75% of its assets, and prepaid interest accounting for another 24% of its assets. *Dunn* at 345. The equipment was subject to rapid depreciation and turnover on a frequent basis. Therefore, the company was constantly buying and selling its heavy equipment on a regular basis like most manufacturing companies purchase inventory.

The Court observed,

> At this point we must emphasize the fact that the lion's share of the Corporation's assets comprised heavy equipment which, to such an operating company, is virtually indistinguishable from consumable supplies — and likely would be so regarded were it not for the administratively necessary but economically unrealistic artificiality of 12-month tax years. Those assets are constantly depreciating from heavy use and obsolescence; they are being replaced to the tune of $2 million annually; their highest and best use is short-term rental, frequently impossible to accomplish without the furnishing of operators by the Corporation; and the tax effects of their unlikely sale to third parties would greatly diminish their value to the Corporation.

*Dunn* at 357.

> Throughout its comprehensive and logical background analysis, the Tax Court recognized that Dunn Equipment is an operating company, a going business concern, the Decedent's shares in which would almost certainly be purchased by a willing buyer for continued operation and not for liquidation or other asset disposition. For purposes of valuation, Dunn Equipment is easily distinguishable from true asset-holding investment companies, which own properties for their own intrinsic, passive yield and appreciation — securities, timberland, mineral royalties, collectibles, and the like.

*Dunn* at 357.

The only appraisal submitted in *Dunn* was that of the Estate's appraiser. The IRS did not have a separate expert in its case. The appraiser used by the estate valued Mr. Dunn's interest using two methods of valuation: (1) capitalization of earnings method or an earnings-based valuation; and (2) an asset-based valuation. The argument centered partially on the proper treatment of the built-in capital gains and partially on the weight to be given to each method of valuation. The Tax Court considered and discussed the various alternatives available to the buyer, other than liquidation; calculated the present value of the future tax liability; and "concluded that the asset-based value of Dunn Equipment should be reduced by only 5% for potential tax costs, not by the full 34% gains tax that the Corporation would have to pay when, and if, its assets were sold . . ." *Dunn* at 352.

The Fifth Circuit in *Dunn* found as follows:

> This is simply wrong: It is inconceivable that, since the abolition of the General Utilities doctrine and the attendant repeal of relevant I.R.C. sections, such as §§ 333 and 337, any reasonably informed, fully taxable buyer (1) of an operational-control majority block of stock in a corporation (2) *for the purpose of acquiring its assets*, has not insisted that all (or essentially all) of the latent tax liability of assets held in corporation solution be reflected in the purchase price of such stock.
>
> We are satisfied that the hypothetical willing buyer of the Decedent's block of Dunn Equipment stock would demand a reduction in price for the built-in gains tax liability of the Corporation's assets at essentially 100 cents on the dollar, regardless of his subjective desires or intentions regarding use or disposition of the assets.

*Dunn* at 352.

In *Dunn*, the Court found that the likelihood of liquidation is inappropriate to the asset-based approach to valuation. *Dunn* at 354. However, the Fifth Circuit in *Dunn* did not fully disregard the likelihood of liquidation in determining the ultimate value of the Corporation. It merely saved that determination to the time in which the weighing of the results would be addressed in a dual valuation scenario.

> (2) our determination that, in this case, the *likelihood* of liquidation or sale of essentially all

> assets be factored into the weighting of the results of the two valuation approaches and . . .

*Dunn* at 358.

The Court in *Dunn* assigned 85% of the value to the earnings-based valuation and 15% to the asset-based valuation. *Dunn* at 358.

Nowhere in its decision does the *Dunn* Court discuss or cite *Eisenberg*, *Davis* or *Welch*. Therefore, it is clear that, on its face, *Dunn* does not reject the holdings in those cases. *Eisenberg*, *Davis* and *Welch* essentially apply to those corporations that are being valued exclusively under the asset method and the Corporation being valued resembles an asset-holding company rather than a going concern. Therefore, *Dunn* is distinguishable on its facts and the methods employed in valuing the Corporation from the corporations in *Eisenberg*, *Davis* and *Welch*.

It is true that under the *Dunn* ruling, 100% of the potential liability for taxes upon the built-in capital gains in the asset approach were held to be deductible as a matter of law from the value of the assets. However, *Dunn* was decided using a different appraisal approach for a company whose value was primarily that of an operating entity and not as an asset-holding company, such as Martin Bros. There is some speculation that *Dunn* may not have meaning beyond the factual context in which two appraisal methods are applied, and when the possibility of liquidation is factored into the relative weight to be given to each approach. John A. Bogdanski, *Closely-Held Businesses and Valuations*, 29 Estate Planning 646 at 648, December, 2002.

Therefore, under *Davis*, *Eisenberg* and *Welch*, it is clear that when the evaluation uses only the asset method, some factual determination must be made about what portion of the built-in gain would be considered by a willing buyer and seller before coming to a conclusion on the value of the assets of a C corporation. This is exactly what happened in the District Court decision from which the Petitioners appeal. It is further worth noting that the Petitioners' own appraiser in this matter did not take a dollar-for-dollar reduction in the value of the assets of Martin Bros. for potential taxes upon the built in gain, but rather engaged in an analysis of what a willing buyer would consider under the circumstances, as did Respondents' appraiser.[5] Only the third appraiser in the

5. A liability for deferred taxes has been recognized with respect to the present value of the excess of fair market values of assets over the related bases of those assets. The liability has been determined using a 7% discount rate and, recognizing the nature of the assets, a 30-year deferral period. *Hendel Business Valuation Report, The Martin Brothers Container & Timber Products Corporation, July 17, 2000*, at 6.

In some cases, it may be appropriate to adjust the net asset value for the tax associated with any built-in capital gains. The adjustment is most appropriate if it is expected that the assets will be liquidated in the foreseeable future. In Martin Bros.' case, it is likely that as a result of the current shareholder dissenter's rights that has given rise to this valuation, we have estimated that the Company will need approximately $1.0 million to satisfy the contemplated stock repurchase. Accordingly we have recognized the Company's off balance sheet liability in the nature of built-in gains taxes on the marketable securities. We have estimated that approximately 50% of the gains will be recognized two years after the Valuation Date. In addition, because of the uncertainty regarding the Company's ability to generate future operating cash flow, we have estimated the remainder of the securities will be sold in equal amounts in each of the subsequent five years. The present value of the tax obligation on these gains — using a 40.0 percent tax rate — is approximately $558,395 as of the Valuation Date.

(Cont'd)

Martin Bros. matter took a dollar-for-dollar reduction for such potential taxes.

Petitioners have attached to their Petition for Writ of Certiorari in this matter several treatises supporting the position that a full deduction of the potential taxes upon built-in gains would be required by any willing buyer. They imply that the opinions of the authors reflect the market on this issue rather than the position of certain gift and estate evaluators.

Respondent rejects this position. A hard and fast rule in this regard ignores the real market in which real buyers and sellers negotiate the sale and purchase of closely-held businesses on a regular basis. In the real world, willing buyers and sellers consider all the facts and circumstances that affect when the gain can be recognized and take that into account when determining the weight to give to built-in gains, such as was done under rulings in *Eisenberg*, *Davis* and *Welch*. Unfortunately, there are few empirical studies on this issue. However, Respondents have located a study conducted in 1994 by The National Association of Certified Valuation Analysts (NACVA) in conjunction with ValueNomics. (*See* Appendix

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(Cont'd)

Because of the uncertainty in the timing of the sale of the Louisiana property, estimating the recognition of the tax obligation resulting from the capital gain is much more difficult. Given the cash flow constraints faced by the Company it is likely that the property will be sold at some point in the next ten years. We have calculated the present value of the tax obligation using a 5.0 percent discount rate assuming a sale in seven years after the Valuation Date. The present value of this off balance sheet liability is estimated to be $646,477. *Comstock Valuation Advisors, Business Valuation, Martin Bros. Container and Timber Products Corp. as of July 18, 2000*, at 36.

A). In the NACVA survey, attorneys specializing in business law, certified public accountants, and business brokers all from the State of California were given a series of survey questions to answer based upon the following facts:

> A corporation owning property purchased in 1970 for $500,000.00, which has been fully depreciated, and now has a market value of $1 million. This asset is assumed to be the only asset of the corporation (tangible or intangible).

The Survey further instructed the participants that their conclusions would assist as follows:

> The Survey results will assist us in determining the probability of how a contingent tax liability on asset appreciation is used in determining current value of closely-held corporate stock.

A significant portion of all the Survey participants indicated that the question of built-in gains would be a factor in determining the price a buyer would pay for a C corporation's stock. However, it is worth noting that of the 95 participants who responded indicating that they believe that a discount is appropriate, the average discount factor was 66%, not the 100% Petitioners argue should be the standard as a matter of law.

In Martin Bros., the operating assets accounted for approximately 30% of the company's assets. The remaining assets consisting of land located in Louisiana and marketable utility stocks. The operating portion of the company generated considerable losses over the years. In fact, there was an annual

loss carryover in Martin Bros., which offset the income the company received on its marketable securities. The company's appraiser opined that was likely that the sale of marketable securities would be required in order to fund operations in the future.[6] All three appraisers of Martin Bros. valued the company as an asset-holding company rather than an operating company.[7]

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6. *Gain on Sale of Securities*. Gains from the sale of marketable securities were non-operating income to the operating business. We reduced income by the amount these gains increased income for the years in which they occurred. The purpose of the sale of these securities has been to keep the Company solvent and meet its supplier and payroll obligations. *Comstock* at 31.

7. In valuing MBC [Martin Bros. Container & Timber Products Corp.], several different approaches to valuation were considered, including an Income Approach, a Market Approach, and an Asset Approach. Considering that MBC's earning capacity is minimal or even negative (particularly when excluding the Company's nonoperating assets), and that the value of MBC's underlying assets is greater than the value of the business reflected by its future cash flows, the Underlying Asset Method, a form of the Asset Approach, was selected in valuing MBC. The Underlying Asset Method is a technique whereby the value of a company is estimated by discretely valuing each of the company's tangible and intangible assets. This methodology is consistent with the methodology employed in the Hendel and ComStock reports.

For purposes of estimating the Fair Cash Value of the Company's common and preferred equity, several conclusions were made with regard to: (1) the Company's adjusted net asset value (i.e., assets less liabilities); and (2) the level of discounts applicable to each class of equity on a per-share basis. *Stout, Risius, Ross Analysis and Report, Martin Bros. Container & Timber Products Corp.*, October 16, 2002, at 4.

In determining the fair market value of Martin Bros. as of July 17, 2000, it is my opinion that the appropriate method to be used is Adjusted

(Cont'd)

*Martin Bros.* is factually distinguishable from *Dunn* and similar to the facts in *Eisenberg* and *Welch*. The Trial Court found that, based upon the testimony adduced at trial, the operating assets would be sold at a likely time, followed by sale of the Company's securities and, later, the Louisiana land. Based upon the time of such dispositions, the Court then reduced the tax (using the rate applicable in July 2000) to its present value as of the valuation date. The net present value of the tax was then deducted from the capital gain. Thus, the Trial Court took into account the facts and circumstances applicable to the Company as of the date of valuation and made the factual conclusions from which Petitioners now seek relief. The Sixth Circuit properly found that the Trial Court acted appropriately. A fact-based approach

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(Cont'd)

Book Value. A business's adjusted book value is calculated by adjusting the book value of the business's assets and liabilities to estimated fair market value as of the date of valuation.

The adjusted book method is used primarily to value holding or investment companies, companies that have no goodwill value or companies whose value is otherwise reflected by asset holdings. In my opinion, Martin Bros. fits within this category. *Hendel* at 9.

The asset approach determines value by examining the fair market value of the Company's assets and liabilities. This method is most relevant when valuing investments or companies that serve as holding companies for various investments. It is less useful for valuing operating companies since it ignores the intangible value of the Company. Any intangible value in a company typically is isolated through examining excess, if any, cash flows generated by a company's underlying assets. While Martin Bros. is an operating company as a result of the Company's sustained losses, a hypothetical willing buyer would likely look to the Company's underlying assets in assessing fair market value. We calculated a value for Martin Bros. using the net asset value method. *Comstock* at 4-5.

continues to be the most appropriate from an open market, buyer and seller, each under no constraints, environment. This Court should deny granting the Writ of Certiorari. *Dunn* was valued as an operating company. In *Dunn*, assets were a component of value, albeit a minor component. *Dunn* was valued primarily as a going concern; whereas Martin Bros. was valued as an asset-holding company. The differences are important.

*Eisenberg*, *Davis* and *Welch* apply to those matters like *Martin Bros.*, when asset valuation method is the sole valuation method used. *Dunn* should apply, if at all, when the company being valued is a going concern and when issues such as liquidation and deferral of gain can be assessed in the weight to be given to multiple method of valuation.

Any conflict regarding the issues presented herein that exists among the Circuits is unimportant and not in need of clarification. This is especially true, since it is unlikely this will be an issue in any subsequent matters involving the Ohio statute, the context within which Martin Bros. was decided.

## CONCLUSION

For the reasons set forth above, this Court should not grant Petitioners' Petition for a Writ of Certiorari.

Respectfully submitted,

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# APPENDIX

# APPENDIX — 1994 STUDY CONDUCTED BY THE NATIONAL ASSOCIATION OF CERTIFIED VALUATION ANALYSTS (NACVA) IN CONJUNCTION WITH VALUENOMICS DATED JANUARY 4, 1994

**Confidential Survey**

**Survey of**

Attorneys Specializing in Business Law
(Members of California Bar)

Certified Public **Accountants**
(multiple state licensed)

and

Business Brokers
(California Licensed)

**Survey performed by**

The National Association of
Certified Valuation Analysts (NACVA)
**in conjunction** with

ValueNomics[sm]
(Business Valuation Research)

January 4, 1994

Thank you for taking time out of your valuable day to assist us in this survey. In return, we will be sharing the results with those who participate. The purpose of this survey is to compile independent data with respect to the experience of qualified individuals regarding the actual behavior of buyers and sellers in certain circumstances.

*Appendix*

The survey pertains to how willing buyers and sellers are dealing with the issue of potential income taxes on highly appreciated property owned by private, closely held corporations where the buyer is considering the purchase of stock rather than assets. As an example, throughout the survey we will use the following as a model: a corporation owning property purchased in 1970 for $500,000, which has been fully depreciated, and now has a market value of $1,000,000. This asset is assumed to be the only asset of the corporation (tangible or intangible).

The survey results will assist us in documenting the probability of how a contingent tax liability on asset appreciation is used in determining current value of closely held corporate stock.

**For your *confidential* participation in this survey, you will receive a complementary copy of the results for use in your practice/business.**

*Appendix*

**Survey**

1 Do your clients (whether buyers or sellers) consider the potential corporate income taxes resulting from the future sale of appreciated property, owned by private, closely held corporations, to be a factor in determining the current value of a corporation's stock?

Yes!: No ❑

2 Which of the following most accurately expresses the position of a willing buyer given all the relevant facts regarding the basis adjustment on the appreciation of the underlying assets?

a. ❑ The low basis in the underlying assets of the corporation, when the buyer acquires stock, is not a relevant issue in calculating the price the buyer will pay.

-or-

b. ❑ The basis in the underlying assets of the corporation is material to the determination of the price the buyer will pay for the stock.

3 Which of the following most accurately expresses the position of a willing buyer given all the relevant facts regarding the tax liability on the appreciation of the underlying assets?

*Appendix*

a. ❑ The contingent nature of the tax liability is not a relevant issue in calculating the price the buyer will pay for the seller's stock. In other words, the tax liability is only realized when the corporation sells the underlying assets and the buyer may defer the tax liability as long as the assets are not transferred through a taxable transaction. Therefore, the threat of having to pay the tax is irrelevant to determining the price, because the risk is controllable.

-or-

The mere existence of contingent tax liability on low basis assets (tangible or intangible) held by the corporation is sufficient for a buyer to discount the price paid for the stock.

4 The buyer of corporate stock does not receive the tax benefit associated with an increase in basis on the appreciated assets within the corporation. In your opinion, does this influence the buyers d

Yes ❑ No ❑, if your answer is yes, please indicate the direction the buyer will most likely attempt to negotiate the price.

Up ❑ Down ❑

5 Which of the following three options would you advise your buyer client to follow in determining the price paid for the model corporation's stock, without consideration for other discounts (fractional, minority and/or lack of control)?

*Appendix*

a. ❑

| | |
|---|---|
| Fair market value of underlying assets | $1,000,000 |
| Basis in underlying assets | 0 |
| Deferred gain on transfer of assets | $1,000,000 |
| | |
| Assume a corporate tax bracket of 35% | |
| Deferred tax on transfer of assets | $ 350,000 |
| | |
| Price buyer will pay for stock, ignoring deferred tax | $1,000,000 |

-or-

b. ❑

| | |
|---|---|
| Fair market value of underlying assets | $1,000,000 |
| Basis in underlying assets | 0 |
| Deferred gain on transfer of assets | $1,000,000 |
| | |
| Assume a corporate tax bracket of 35% | |
| Deferred tax on transfer of assets | $ 350,000 |
| | |
| Price buyer will pay for stock | $ 650.000 |

-or-

c. ❑ A percentage of the contingent tax liability is deductible from the value of the stock, but less than 100%. Please circle a specific choice as to the percentage you feel is most correct as the amount to be deducted.

1 0%

50% 100%

*Appendix*

6 If a discount is taken for a contingent tax liability, would this deduction influence other discounts being considered by the buyer/seller, such as fractional interest, minority interest and/or lack of control.

Yes ❑ No ❑, if your answer is yes, then circle how likely you feel a contingent tax liability deduction would affect other discounts being considered.

| 0 | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|

Not at all Always

7 In your opinion, do the contingent tax liability issues pertain equally to intangible as well as tangible assets?

Yes ❑ No ❑

8 Confidential information necessary to validate response and forward your copy of survey results:

Signature _____

Date _____

Attorney, broker or CPA

*Appendix*

**Section I — Introduction**

This report contains an analysis of the results of the NACVA/ ValueNomics Survey. The primary conclusion that can be drawn from the responses to the survey is that a large majority of buyers will, ceteris paribus, discount the stock price of a corporation due to the existence of a contingent tax liability on the appreciated property that the corporation holds. The second section, which is divided into five parts, is a statistical analysis of the survey results. The page numbers in parentheses in the second section refer to the computer printout that follows this report. The third section covers data quality, and the fourth section explains technical statistical topics that are pertinent to the analysis of the data.

**Section II — The Results**

Part A: Questions one through five.

THE ENTIRE SAMPLE. (p1) Questions two through five (Q2-Q5) show that, for the entire sample, there is an 82% probability that a willing buyer will discount the price paid for the stock of a corporation due to the existence of a contingent tax liability on the appreciated assets of the corporation. This is actually the sample estimate based on an equally weighted average of questions two through five. There is a 95% probability that the true population percentage is between 75% and 90%. In other words, there is only one chance in forty that less than 75% of the members of the population would discount the stock price because of the contingent tax liability.

*Appendix*

Question one was not included in this calculation because it is the only question that mentions sellers as well as buyers. However, including question one (ppl,2) and weighting question one through five equally changes the probability from 82% to 81%, which is a very minor difference. The 95% Confidence interval is [74% - 89%], which is almost identical to [75% - 90%1.

CPAs. Q2-Q5 and Q1-Q5. (pp3,4) The probability for CPAs is 82%, and the 95% confidence interval is [74% - 91%]. This interval is slightly larger than the confidence interval for the entire sample, because there is less data to make an inference from due to the reduction in sample size. Adding question 1 changes our sample estimate from 82% to 81% and shifts the corresponding confidence interval down by one percent.

ATTORNEYS and BUSINESS BROKERS - AN IMPORTANT CAVEAT. Due to the small sample size for attorneys and business brokers, the sample estimates derived for these two populations might not be too close to the actual (but unknown) population values. This relative lack of confidence in the estimates obtained from the samples of business brokers and attorneys will be reflected in rather large confidence intervals. For more on this issue, please see the fourth section of this paper on technical statistical issues.

ATTORNEYs. Q2-Q5 and Q1-Q5 (Text and pp.5-7) The probability calculated for this group is 89%. The 95% confidence interval is from 62% to 98%. The results do not change when question one is included.

*Appendix*

BUSINESS BROKERS. Q2-Q5 and Q1-Q5 (Text) The probability here is 75%, and there is a 95% chance that the true population probability is between 47% and 93%. Adding question one changes the calculated probability to 72%, and the 95% confidence interval to [43% - 91%].

Part B: Question four.
For all three populations and for the entire sample the results to the second half of this question are unanimous. For those who answered that a buyer of corporate stock will be influenced by the fact that the buyer does not receive the tax benefit associated with an increase in basis on the appreciated assets within the corporation, every single response indicated that the buyer will attempt to negotiate the price downwards. Clearly, the lack of the tax benefit described above decreases the price that a buyer is willing to pay for the corporation.

Part C: Question five.
This question quantifies the discount in price that a buyer believes is appropriate to offset the contingent tax liability. The answer is in terms of the percentage of the contingent tax liability that the stock price of the corporation should be reduced by. There are two universes of respondents for which this analysis is appropriate: one, those who responded yes or no; two, only those who answered yes. The second group will provide the discount factor for just those buyers who deem that a discount should be taken.

THE ENTIRE SAMPLE. (p8) Out of the 97 respondents who believe that a discount is appropriate, the average discount factor is 66%. When those who believe that no discount should be taken are included, the average discount is reduced to 63%.

*Appendix*

ATTORNEYS. (pp9,10) The discount factor is 61% for attorneys, who all answered that a discount is appropriate in question five.

CPAs. (pp9,10) The discount factor is 67% for those who think that a discount is appropriate, and 63% when the zero percent discount responses are included.

BUSINESS BROKERS (pp9,10) The discount factor is 60% overall, and 70% for those brokers who do believe that a discount is appropriate.

Part D: Question six.
This is a two part question. The first part asks that if there is a discount taken for a contingent tax liability, would this deduction influence other discounts being considered by the buyer/seller. The second part of the question asks respondents who answered yes to indicate how likely they feel that a contingent tax liability deduction would affect other discounts being considered. The only responses that are valid for the second part of this question are the ones given by the respondents who answered "yes" in the first part of the question. In my professional opinion, the second part of this question will not produce very meaningful results. The second question restates the first question, but only asks it of those who answered yes for the first question. The first part of this question, with the yes or no answer, is therefore the one for which the results are reported below. However, the results to the second part, with the zero to five scale, are reported on pages 9-11 of the computer printouts.

*Appendix*

THE ENTIRE SAMPLE. (p11) There is a 47% probability that a contingent tax liability deduction would influence other deductions being considered by the buyer/seller. The 95% confidence interval for this percentage is [.38 - .57].

CPAs. (p12) The probability for CPAs is 44%. The 95% confidence interval is [33%-55%].

ATTORNEYS. (text) The probability for attorneys is 77%. The 95% confidence interval is [48%-95%].

BUSINESS BROKERS. (text) The probability for brokers is 40%. The 95% confidence interval is [16%-68%].

Part E: Question seven.
THE ENTIRE SAMPLE. (p13) There is a 59% probability that the contingent tax liability issues pertain equally to intangible as well as tangible assets. The 95% confidence interval for this percentage is from [.50-.68].

CPAs. (p14) The probability for CPAs is 64%, and the 95% confidence interval is [53%x-75%].

ATTORNEYS. (text) The probability is 57% with a 95% confidence interval of [29%-83%].

BUSINESS BROKERS. (text) The probability is 31% with a 95% confidence interval of [7% to 60%].

*Appendix*

**Section III — Data Quality**

The individual responses listed in the material labeled as "reference" were assumed to be entirely correct. After discovering an error in the results for question number six, the data quality was checked and rechecked for all seven of the survey questions. The few errors that were discovered were corrected. The statistical analysis conducted in this report is an accurate representation of the data as it is listed in the reference section. The actual work performed to ensure the quality of the data is written on the reference sheets and the pages listing the individual responses to questions five and six. The author recognizes the importance of accurate data and has taken steps to ensure the data quality.

**Section IV — Technical Statistical Issues**

This section will explain a few statistical concepts relevant to the analysis of the survey data. The statistical tests used in this report to generate the computer printouts assume that the data comes from a normal distribution. In most cases even if this is not true, the sample size is large enough so that using the normal approximation for the actual distribution of the data is a valid technique. However, for questions with a yes/no answer, which are from a binomial distribution, the sample size must be sufficiently large to use the normal approximation to the binomial distribution. A sample size of 15 is not large enough to validate the use of the normal approximation, so a different statistical technique must be used to calculate the 95% confidence interval. The technique that was used is from a statistical reference text, and is the proper way to analyze a small sample from a binomial distribution. When this technique was used in this report it is noted by (text).